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No. 14-840

In the Supreme Court of the United States

FEDERAL ENERGY REGULATORY COMMISSION,
PETITIONER

v.

ELECTRIC POWER SUPPLY ASSOCIATION, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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I. THE FEDERAL POWER ACT AUTHORIZES FERC'S WHOLESALE DEMAND-RESPONSE RULES

Wholesale-market operators make demand-response payments to eligible electricity users as part of the process of setting wholesale prices in auctions and operating the interstate grid. Those payments are uniquely critical to the reliability and competitiveness of modern wholesale markets and transmission systems. See Grid Eng'rs and Experts Amicus Br. (Grid Experts Br.) 6. For that reason, FERC reasonably determined that demand-response payments are "practice[s] * * * affecting" wholesale rates and therefore that it has the duty to ensure that the compensation formula for the payments produces just and reasonable wholesale rates. 16 U.S.C. 824e(a).

Respondents do not dispute (Br. 46) that FERC has exclusive authority to regulate the pricing and reliability practices of wholesale-market operators. And they acknowledge that States lack the power to regulate demand-response payments made by wholesale-market operators to electricity users. But respondents appear to argue that the Federal Power Act (FPA) denies FERC the power to regulate those payments as well—and indeed that such payments, and therefore any demand-response participation by electricity users in the wholesale markets, are altogether prohibited. This sweeping reach of respondents' position is advanced for the first time in their merits brief in this Court. Before FERC, respondents expressly *supported* the inclusion of demand-response resources in wholesale energy markets. See FERC Br. 33.

In any event, respondents' contention lacks merit. Demand-response payments by wholesale-market operators expressly fall within FERC's Section 824e(a) authority over "practice[s] * * * affecting" wholesale rates. Those payments are made by wholesale-market operators in wholesale markets for the purpose of balancing wholesale supply and demand, setting wholesale prices at optimal levels, and enhancing the reliability of the interstate grid—benefits that respondents' self-defeating interpretation of the FPA would foreclose. At the same time, FERC's rules governing such payments fully respect the authority the FPA reserves to the States to set retail rates. A State remains free to set any retail rate it chooses based on any policy considerations it finds persuasive, and may prohibit its electricity users from participating in wholesale demand-response

programs if it deems such participation incompatible with its regulatory objectives. Thus, FERC's wholesale demand-response rules are plainly within its statutory authority. And even if the question were close, FERC's judgment would be entitled to *Chevron* deference.

A. Demand-Response Payments By Wholesale-Market Operators Are Practices Affecting Wholesale Rates

1. FERC has authority under Section 824e(a) to regulate practices that directly affect wholesale rates. See FERC Br. 24-29. That includes the authority both to permit wholesale-market participants and operators to engage in those practices and to regulate how those practices are conducted.

Respondents appear to suggest (Br. 24-29), based on the FPA's general declaration of policy in 16 U.S.C. 824(a), that FERC's authority is more limited than what the plain text of Section 824e(a) states—in respondents' newly coined term, that FERC possesses only "interstitial authority" to regulate in those areas where state regulation is constitutionally prohibited. Of course, that would not provide a basis for denying FERC's authority here, as respondents have acknowledged (Br. 46) that States do lack the authority to regulate the wholesale demand-response practices covered by the Rule.

Even more to the point, respondents' view has been rejected again and again by this Court, in cases that respondents do not even discuss. See FERC Br. 36-38. In *New York* v. *FERC*, 535 U.S. 1 (2002), the Court explained that it is "perfectly clear that the original FPA did a good deal more than close the gap in state power identified in [*Public Utilities Commission of Rhode Island* v. *Attleboro Steam & Electric*

Co., 273 U.S. 83 (1927)]," 535 U.S. at 21, and just last Term the Court underscored that in this area there is no "clear division between areas of state and federal authority," *ONEOK, Inc.* v. *Learjet, Inc.*, 135 S. Ct. 1591, 1601 (2015) (Natural Gas Act). That understanding is hardly consonant with respondents' portrayal of constricted FERC authority and hermetically sealed spheres of regulation.

Respondents make no effort to reconcile their view that the FPA's policy declaration relegates FERC to an "interstitial" role with this Court's repeated recognition, over seven decades, that "the precise reserved state powers language" in that declaration "cannot nullify a clear and specific grant of jurisdiction" to FERC. *New York*, 535 U.S. at 22 (quoting *Connecticut Light & Power Co.* v. *FPC*, 324 U.S. 515, 527 (1945)). Given that "nothing in the Act[] suggests that federal authority over practices [under Section 824e(a)] is a second-class power," *ONEOK, Inc.*, 135 S. Ct. at 1605 (Scalia, J., dissenting on other grounds), the question here is simply whether demand-response payments by wholesale-market operators have a direct effect on wholesale rates.

2. The answer to that question is yes. See FERC Br. 24-29. Wholesale-market operators use demand-response bids to set wholesale rates—that is, to arrive at the price points at which the supply and demand curves for wholesale power intersect. Demand-response programs lower wholesale rates and reduce the risk of curtailments or other disruptions to the interstate grid. See Grid Experts Br. 13-27. And demand-response payments are recouped directly from wholesale purchasers. FERC therefore correct-

ly concluded that their effect on wholesale rates is "direct and substantial." Pet. App. 198a.

Respondents block quote (Br. 13, 26) FERC's regulatory definition of "demand response," 18 C.F.R. 35.28(b)(4), as if it proves that FERC is regulating retail and not wholesale sales. But all the definition says is that demand-response commitments involve a promise to reduce the consumption of electricity. No one disputes that fact. See FERC Br. 9-11, 41-42. The critical point is that, while an electricity user that makes a wholesale demand-response bid is itself "neither selling nor buying electricity for resale" (Resp. Br. 30), the wholesale-market operator uses that bid as part of a pricing mechanism to set rates for those that are.

Respondents also argue (Br. 33) that, while "[o]f course a retail customer's decision to refrain from purchasing electricity has an effect on the wholesale markets," "that effect * * * is no more (or less) 'direct' than the effect that any retail transaction has on the wholesale markets." That argument rests on a mischaracterization of the Rule's scope and legal basis. FERC has not asserted jurisdiction over *all* payments to electricity users to refrain from using electricity (*e.g.*, payments by local utilities to their customers), and it has not relied on "the truism that retail consumption affects wholesale rates" (*id.* at 46) as the justification for its exercise of authority. The Rule addresses only those payments made by wholesale-market operators to parties that bid into wholesale markets as part of establishing the rate for wholesale sales of electricity in auctions and operating the interstate transmission grid. Those payments plainly have the requisite direct effect on wholesale rates, unlike

the general patterns of retail consumption to which respondents' "truism" refers.

3. Respondents cryptically assert (Br. 34) that "[t]o the extent the effect [of wholesale demand-response payments on wholesale rates] is especially direct, that is only because FERC has made it so." Respondents appear to suggest that FERC, in approving changes to operators' tariffs permitting demand-response programs, has foisted upon wholesale-market operators a practice that is not intrinsically beneficial to wholesale markets. See Resp. Br. 30, 34. We agree that FERC could not force regulated utilities to adopt a pricing practice that has no intrinsic benefit for wholesale markets or the operation of the interstate grid. Such an order would be arbitrary and capricious in light of FERC's duty to ensure that wholesale rates are just and reasonable. But respondents' depiction of wholesale demand-response programs as a kind of unnatural appendage grafted onto wholesale markets profoundly misconceives the history, purpose, and operational benefits of those programs.

As we explain in our opening brief (at 5-6), in 1996 and 2000, following Congress's lead, FERC issued orders that reshaped the wholesale-electricity system by, among other things, encouraging wholesale-market operators to manage the interstate grid and "run[] auction markets for electricity sales." *Morgan Stanley Capital Grp.* v. *Public Util. Dist. No. 1 of Snohomish Cnty.*, 554 U.S. 527, 536-537 (2008); see *New York*, 535 U.S. at 9. In designing their auction markets, wholesale-market operators themselves recognized that demand-response programs were integral to reliable operations and efficient pricing.

See Pet. App. 63a & n.27. Thus, ISO New England, PJM Interconnection, and California ISO initially sought and obtained FERC approval to institute demand-response programs in 2000; New York ISO followed suit in 2001; and Midcontinent ISO did so in 2004, concurrently with the launch of its day-ahead and real-time energy markets.[1] In seeking FERC approval, the wholesale-market operators explained that demand-response programs are "an added tool for alleviating congestion and enhancing reliability" that would enable them "to better balance supply and demand without resorting to involuntary curtailments or other non-market actions," *Midwest Indep. Transmission Sys. Operator, Inc.*, 108 F.E.R.C. ¶ 61,163, at 61,968 (2004), and would "reduce energy costs by encouraging load to reduce demand during times of short supply, thus helping to keep prices reasonable and prevent price spikes," *PJM Interconnection, L.L.C.*, 99 F.E.R.C. ¶ 61,227, at 61,935 (2002).

Then, in 2005, Congress made it the "policy of the United States" to remove barriers to demand response. See EPAct § 1252(f), 119 Stat. 966 (16 U.S.C. 2642 note).[2] In light of that directive, FERC promul-

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[1] See PJM Br. 23 n.11; *ISO New England, Inc.*, 88 F.E.R.C. ¶ 61,304 (1999); *California Indep. Sys. Operator Corp.*, 91 F.E.R.C. ¶ 61,256 (2000); *New York Indep. Sys. Operator, Inc.*, 95 F.E.R.C. ¶ 61,136 (2001); *Midwest Indep. Transmission Sys. Operator, Inc.*, 108 F.E.R.C. ¶ 61,163, at 61,968-61,969 (2004).

[2] Although respondents contend (Br. 44) that the congressional directive related only to state-level programs, they rely on a different subsection of the statute that established a separate policy of state coordination on demand response. See EPAct § 1252(e), 119 Stat. 965-966 (16 U.S.C. 2642 note). Respondents provide no statutory support for their assertion (Br. 44-45) that the distinct policy in Section 1252(f) applies only to barriers in

gated an order in 2008 requiring operators to accept bids from aggregators (unless prohibited by state regulators), but permitted each operator to continue to "develop its own compensation methodologies." Pet. App. 63a. Finally, in the Rule at issue here, FERC set out to determine whether a particular compensation formula best advances the reliability and competitiveness of wholesale markets, ultimately adopting the "locational marginal price" (LMP) formula.

Given that the impetus for wholesale demand-response programs came from wholesale-market operators responding to market forces, there is no basis for respondents' suggestion that FERC has artificially created the direct link between demand-response programs and wholesale rates in order to impose its regulatory agenda on retail markets. As the nascent wholesale auction markets took shape in the early 2000s, FERC approved the operators' requests to establish and expand demand-response programs because it found that they enhance the reliability and competitiveness of wholesale markets—benefits that FERC catalogued in the record below and in prior orders, and that diverse amici have described in this Court. Pet. App. 59a-61a; see Order No. 719, 73 Fed. Reg. 64,103 (Oct. 28, 2008); see also, *e.g.*, PJM Interconnection Br. 10-42; State Resps. Br. 8-39; Illinois Amicus Br. 3-17; NRG Energy Amicus Br. 6-10; Elec. Consumers Amicus Br. (Consumers Br.) 6-18.

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wholesale markets that inhibit retail demand-response programs, particularly given its reference to "capacity" and "ancillary services" markets (see FERC Br. 35) and to the benefits of demand response for all entities that are "part of the same regional electricity entity."

As the grid engineers and experts explain in their amicus brief in support of neither party (at 24), demand-response programs not only "exert a significant influence on price during periods of peak demand," but also enhance the operational reliability of the grid, which itself contributes to lower wholesale costs. In particular, balancing the system solely with added generation can be "costly and inefficient," *id.* at 18, for a host of operational reasons, and can require grid managers to bring particularly inefficient high-cost generation online because physical constraints prevent the use of less costly generation. *Id.* at 13-27. And over the long term, "[r]educing consumption at or near system peaks can postpone or eliminate the need for expensive investment in additional generating capacity," Illinois Amicus Br. 17, and "can potentially lessen the need for additional transmission system upgrades," Grid Experts Br. 7.

In addition, the benefits of wholesale demand-response programs would not be fully achievable through state-level programs, such as where local utilities give rebates to their customers for curtailing power use at certain times. See NRG Energy Amicus Br. 20-22; Consumers Br. 15-18; Cal. Pub. Utils. Comm'n Br. 11-16. A wholesale-market operator has access to far more real-time information about system-wide needs than a single local utility. Local utilities also lack the ability to dispatch demand-response resources in one geographic area to address issues in another area within a large, multi-state region. Demand-response programs in the wholesale capacity and ancillary-services markets, moreover, create additional reliability and competitiveness benefits. See State Resps. Cert. Br. 31 ($9.3 billion price

increase from eliminating demand response from capacity markets).

In short, demand-response programs were adopted by wholesale-market operators and approved by FERC expressly because they are intrinsically beneficial to the *wholesale* ratesetting process and the day-to-day management of the interstate grid. The undercurrent of respondents' arguments—that FERC has artificially linked demand-response payments to wholesale rates in order to extend its authority to override state retail-rate regulation—therefore represents a wholly unsupported account of the regulatory history. Like any other mechanism used to determine wholesale rates and manage the grid, demand-response payments are "practice[s] * * * affecting" wholesale rates. 16 U.S.C. 824e(a).

B. The FPA Does Not Prohibit Wholesale-Market Operators From Making Demand-Response Payments

Unable to deny that wholesale demand-response payments are "practice[s] * * * affecting" wholesale rates within the meaning of Section 824e(a), respondents contend that the FPA should nonetheless be read to contain an implicit prohibition on that practice. They argue (i) that those payments violate Section 824(b)(1)'s bar on FERC regulation of retail sales, and (ii) that they otherwise "obliterate[]" (Br. 33) the FPA's allocation of authority between federal and state regulators. Neither argument has merit.

1. As we explain in our opening brief (at 38-40), FERC's authorization of wholesale demand-response payments does not violate Section 824(b)(1) because those payments are not "sale[s] of electric energy" at retail and do not change the terms of any retail "sale." Respondents nonetheless insist that FERC is regulat-

ing retail rates by "dictating" or changing the "effective rate" for retail transactions. See Resp. Br. 1-3, 10, 12, 18-19, 25-29, 30, 35-36, 38-39, 46. Respondents even go so far as to assert that demand-response payments are the "functional equivalen[t] of *raising* [retail] rates directly." *Id.* at 1, 35-36 (emphasis added). That argument is legally flawed and deeply misguided.

Respondents' repeated assertion that FERC is regulating retail rates is simply wrong. States, not FERC, regulate retail rates, *i.e.*, the price charged by a local utility for actual sales of electricity to end users. See 13 *Oxford English Dictionary* 208-209 (2d ed. 1989) ("rate" means "[p]rice," "cost," or "sum paid or asked for a * * * thing"). All retail customers pay the state-approved retail rate for electricity, and States have full authority to insulate their citizens from the vicissitudes of the electricity market through rate regulation if they wish to do so.

Respondents' "rate regulation" and "functional equivalence" arguments therefore cannot be that FERC has increased the *actual* price of purchasing retail electricity. Rather, those terms are simply respondents' misleading labels for what they see as the impact that demand-response programs in wholesale markets could have on electricity users' economic calculus—*i.e.*, that a customer might consider, when deciding whether to use electricity, both the actual retail rate for purchasing electricity and the potential forgone demand-response payment if it does so. But deeming the availability of that payment to be the legal equivalent of retail-rate regulation is like equating a tax credit for purchasing an electric car with a mandatory increase in the price of gas. Offering a

financial incentive not to engage in an economic transaction is not ordinarily understood as regulating the legal terms of such a transaction if it were actually entered into, even though the incentive may affect a person's decision whether to engage in the transaction. Cf. *South Dakota* v. *Dole*, 483 U.S. 203, 206 (1987). Nothing in the FPA suggests that Congress meant to import respondents' notion of the "effective" retail rate—the theoretical construct that a purchaser "pays" both the actual price of the good plus any forgone incentive payment to refrain from purchasing the good—into the FPA's prohibition on FERC's regulation of retail "sales." Congress had in mind real-world transactions and concrete regulation of those transactions—not behavioral theories and abstract models—when allocating jurisdiction between FERC and the States.[3]

The irony at the heart of respondents' argument is that what they describe as "functional[ly] equivalen[t] to retail rate increases" (Br. 28) is, in the real world, a practice that leads to lower *actual* retail rates—to the benefit of all consumers, but to the detriment of the least efficient generators—by reducing wholesale costs. By deeming a payment for non-consumption the legal equivalent of a mandated increase in the

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[3] Respondents see a material "concession" (Br. 38) in our acknowledgment that FERC could not regulate a demand-response program that operates by giving consumers credits that reduce what they pay for other retail purchases. See FERC Br. 40. But that theoretical scheme (which could not be run by wholesale-market operators in any event) *would* alter the terms of "fully consummated sales" at the retail level (Resp. Br. 38), by changing the rates charged by local utilities.

retail price of electricity, respondents would have this Court hold that a wholesale program indisputably designed to reduce the rates that real people pay for electricity is unlawful because, in some highly theoretical sense, it could be described by some as increasing the "effective" retail rate of electricity for those customers who purchase electricity at periods of high demand and thereby forgo demand-response payments. This Court should eschew respondents' atextual and inverted vision of the FPA, and should instead sustain FERC's straightforward and reasonable interpretation of the statutory text.

2. Section 824(b)(1) aside, respondents contend (Br. 2-3, 23, 31, 34, 46) that FERC has "lured [retail customers] into these wholesale markets * * * because FERC is dissatisfied with the States' exercise of their undoubted authority to regulate retail demand," and has thereby upset the federal-state balance reflected in the FPA's declaration of policy. That argument lacks merit as well.

a. To the extent respondents' argument hinges on the accusation that FERC has artificially grafted demand-response programs onto wholesale markets in a clandestine effort to circumvent state retail regulation, that account is demonstrably incorrect for the reasons discussed above. See pp. 6-10, *supra*; see also Grid Experts Br. 13-27. It is also refuted by pertinent FERC regulations and operator tariff provisions that expressly provide that they do not apply if demand-response participation is "not permitted by the laws or regulations of the relevant electric retail regulatory authority." 18 C.F.R. 35.28(g)(1)(i)(A) (ancillary services); see 18 C.F.R. 35.28(g)(1)(iii) (similar rule for aggregators); *Indiana Util. Regulatory Comm'n* v.

FERC, 668 F.3d 735, 737 (D.C. Cir. 2011) (discussing PJM tariff). That veto power for state regulators (which does not require new "legislation," Resp. Br. 42) would make no sense if the purpose of FERC's actions over the past 15 years were, as respondents assert, to impose dynamic pricing on unwilling States. Rather, the veto reflects an effort to accommodate and complement state initiatives in the absence of an overriding justification for a single federal rule. Cf. *New York*, 535 U.S. at 24-28. And nothing about wholesale demand-response programs impedes States from stabilizing retail rates (see pp. 11-12, *supra*).

It is thus unsurprising that no State registered an objection to FERC's exercise of authority in the rule-making record here, filed an opposing amicus brief in the court of appeals, or sought judicial review of prior FERC orders permitting demand-response programs. Although 16 States or their utility commissions have now submitted two amicus briefs supporting respondents' position on the statutory question, ten of those States lie either entirely or mostly outside of the regions that wholesale-market operators cover, where the Rule has legal effect. See FERC, *Map: Regional Transmission Organizations (RTO)/ Independent System Operators* (Sept. 17, 2015).[4] And even the objecting States apparently agree that "retail customers may continue to bid their demand response directly into the wholesale market if their State permits that practice" (Indiana Amicus Br. 33)—which is inconsistent with respondents' position that the FPA forecloses any such participation.

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[4] http://www.ferc.gov/industries/electric/indus-act/rto.asp.

b. To the extent respondents instead argue that the FPA bars FERC from authorizing any practice that involves electricity consumers or the "retail market," regardless of its effect on wholesale rates, they are incorrect.

Respondents cannot deny (Br. 46) that FERC may regulate wholesale markets in a way that affects the "retail market." After all, everything that FERC does, from approving wholesale rates to allocating wholesale costs among related entities to approving the design of wholesale auctions, can exert a powerful effect on the "retail market," because wholesale costs are ultimately reflected in retail rates. See *Entergy La., Inc.* v. *Louisiana Pub. Serv. Comm'n*, 539 U.S. 39, 47-48 (2003). And the fundamental purpose of FERC regulation is to safeguard the "public interest," 16 U.S.C. 824(a), so its "first and foremost duty is to protect consumers," *Morgan Stanley*, 554 U.S. at 551 (citation omitted) (approvingly quoting FERC order).

Respondents find it "jurisdictionally meaningful" (Br. 32), however, that demand-response programs involve electricity consumers by changing their incentives to purchase power. But no provision of the FPA imposes a blanket prohibition on wholesale-market practices that involve electricity consumers, or on FERC's authorization or regulation of such practices. It is true that many practices that involve electricity consumers, such as state-level demand-response programs, do not directly affect wholesale rates or interstate transmissions, and therefore fall exclusively within the province of state regulators. But the specific practice at issue here *does* directly affect wholesale rates. That means that FERC has authority over that practice under the plain text of Section 824e(a).

In other words, the "jurisdictionally meaningful" distinction is not between practices that involve electricity consumers and practices that affect the "retail market" in other ways—a distinction found nowhere in the FPA—but between practices that directly affect wholesale rates and those that do not, see 16 U.S.C. 824e(a).

In that critical respect, the roles of FERC and state regulators are not symmetrical, as respondents erroneously contend (Br. 37-40). Wholesale demand-response programs *both* directly affect wholesale rates (the exclusive subject of federal regulation) *and* involve electricity users (whose rates for actual purchases of electricity at retail are subject to state regulation). In that sense the programs straddle the two traditional spheres of regulation, although their effect on the state sphere is indirect. But because the FPA expressly grants FERC the power to authorize and regulate any practice "affecting" wholesale rates, without material qualification, it is FERC, and not the States, that has plenary authority over demand-response payments in wholesale markets. And because, conversely, the FPA does not expressly reserve to the States exclusive authority over all practices "affecting" retail rates, the impact of FERC's regulation of wholesale-market demand-response rates on retail demand (and therefore indirectly on retail rates) does not impermissibly intrude on the States' domain.

Respondents' contrary position rests on a crabbed and self-defeating view of the FPA. As this Court explained in the principal decision on which respondents rely (Br. 24-25), "Congress meant to create a comprehensive and effective regulatory scheme" of "cooperative action between federal and state agen-

cies" to "protect consumers against exploitation." *Panhandle E. Pipe Line Co.* v. *Public Serv. Comm'n of Ind.*, 332 U.S. 507, 520 (1947) (Natural Gas Act) (footnote omitted). Yet respondents read the FPA to implicitly prohibit both FERC and state regulators from authorizing a practice that benefits consumers in a unique and important way. Congress could not have intended the FPA's broad grant of federal jurisdiction to implicitly proscribe a practice that holds down peak wholesale prices and makes the Nation's electricity system operate more reliably and efficiently.

C. FERC's Interpretation Is Reasonable Under *Chevron*

Whatever else might be said of respondents' statutory arguments, their position does not follow unambiguously from the text of the FPA. The notion that it did would require the Court to accept that a non-sale is statutorily equivalent to a "sale," or that a purported bar on FERC's regulation of practices "subject to regulation by the States," 16 U.S.C. 824(a), encompasses a practice that is not, in fact, "subject to regulation by the States." Even if such counter-textual inferences were permissible interpretations of the FPA, they would not be compelled. And contrary to respondents' contention (Br. 42-43 & n.7), ordinary *Chevron* principles apply to FERC's interpretation of the scope of its authority under the FPA, which is "indisputably a question of federal law." *City of Arlington* v. *FCC*, 133 S. Ct. 1863, 1871, 1873 (2013); see, *e.g.*, *Mississippi Power & Light Co.* v. *Mississippi*, 487 U.S. 354, 380-383 (1988) (Scalia, J., concurring in the judgment). Because FERC's interpretation is at least reasonable, it is entitled to judicial deference.

II. RESPONDENTS' OBJECTIONS TO THE LMP FORMULA DO NOT SHOW THAT IT IS ARBITRARY AND CAPRICIOUS

In contending that the LMP compensation level selected by FERC is arbitrary and capricious (Resp. Br. 49-60), respondents discuss none of the decisions of this Court describing the standards of judicial review of administrative action, leaving the impression that the Court must embark on a de novo review of the competing economic theories and practical arguments that FERC considered in promulgating the Rule. But the arbitrary-and-capricious standard is a "narrow standard of review," *FCC* v. *Fox Television Stations, Inc.*, 556 U.S. 502, 513 (2009) (citation and internal quotation marks omitted), and this Court affords FERC "great deference" in technical ratemaking decisions, *Morgan Stanley*, 554 U.S. at 532. Absent such deference, lower courts would be inundated with suits seeking fresh reassessments of the myriad technical choices that FERC and other agencies make in the ordinary course of fulfilling their statutory duties.

In the Rule, FERC made a highly technical judgment that resolved the competing views of numerous commenters on the appropriate compensation formula for demand-response commitments, including a disagreement among expert economists—a disagreement that persists in the briefing in this Court. Compare Cicchetti Amicus Br. and Kolstad Amicus Br. with Borlick Amicus Br. FERC's reasons for choosing LMP were well explained and fully consistent with its goal of reducing peak wholesale rates and making the interstate grid more reliable and competitive. The Rule should therefore be sustained.

A. LMP Reasonably Serves The Regulatory Purposes That FERC Set Out To Achieve

Respondents have identified no sound basis to set aside FERC's adoption of the LMP formula.

1. a. Respondents' primary argument (Br. 59) is that LMP is "divorced from [FERC's] stated rationale" for demand-response programs in wholesale markets. But respondents misidentify "FERC's stated and unchanged purpose" as forcing retail prices to "reflect the real-time pricing that governs" wholesale prices. Br. 49; see Br. 15, 19. The purpose of wholesale demand-response programs is not to change retail rates or to force demand-response providers to face precisely the incentives they would face in a regime of fully dynamic retail pricing. Rather, the programs' purposes are to ensure just and reasonable rates in the *wholesale* market; to ensure that the wholesale system avoids involuntary curtailments and other reliability problems when the interstate system is strained; to avoid bringing online the most inefficient generation during peak periods; and to mitigate the market power of generators in wholesale markets. Pet. App. 59a-61a, 189a-190a.

The only record support that respondents cite for FERC's alleged goal of imposing real-time retail pricing is one sentence in which it observed that increased demand-response participation would "mov[e] prices closer to the levels that would result if all demand could respond to the marginal cost of energy." Pet. App. 99a. In their brief (at 50), respondents insert the word "[retail]" before "prices" in that sentence. But the sentence was referring to *wholesale* prices, as is apparent from its overall context, FERC's reiteration of the same point in its order on rehearing, see Pet.

App. 217a, and FERC's repeated statement that the Rule was "not regulating retail rates" or "usurp[ing] or impeding state regulatory efforts," *id.* at 138a, 199a. Whether retail rates should be responsive to electricity demand is left entirely up to state regulators. And although the order on rehearing noted that more demand-response participation in wholesale markets, which reduces wholesale-rate peaks, "will cause wholesale and retail prices to converge," *id.* at 216a, it did not suggest that the objective of wholesale demand-response programs is "to effectively align[] wholesale and retail prices" (Resp. Br. 49).

b. Considered in light of the actual purposes of demand-response programs and the Rule, the LMP formula reflects a reasonable policy judgment entitled to judicial deference. Respondents and their amici do not dispute FERC's conclusion that, when used in conjunction with the net-benefits test, the LMP formula results in lower wholesale rates for all purchasers by enabling operators to balance supply and demand at a lower price point during peak periods. See FERC Br. 50-56. Nor do they take issue with the operational and competitiveness benefits from greater demand-response participation that FERC identified, or FERC's finding (echoing Congress's finding in the EPAct) that significant barriers exist to full participation of demand-response resources in wholesale markets, such as inadequate "investment in demand response resource infrastructure and expertise." Pet. App. 98a (internal quotation marks omitted); see *id.* at 59a-61a, 90a-99a, 137a-138a, 212a-221a.

In light of those findings, FERC reasonably concluded, consistent with Dr. Kahn's expert analysis, that a formula that paid generators more than

demand-response providers for providing the same value to the wholesale system was not warranted and would induce insufficient demand-response participation. See FERC Br. 50-56. That was an entirely reasonable judgment. Although respondents declare (Br. 56) that it is "fanciful" to conclude that a reduction in demand is a resource of equivalent value to the interstate-market system as an equivalent increase in supply, they provide no intelligible basis for their assertion.

2. The amici economists who support respondents take a different approach. They argue (Borlick Amicus Br. 12-16) that FERC was required, apparently as a matter of law, to conceptualize a demand-response commitment as equivalent to a purchase of power at retail that is then resold to the interstate grid, a sequence that would be net compensated at LMP-G. But reasoned decisionmaking did not require FERC to adopt that artificial construct. A demand-response commitment is not a purchase and resale of power, but rather a promise to refrain from exercising the right to purchase power when doing so would put strains on the wholesale system. It was eminently reasonable for FERC to require that commitment to be compensated based on the value it brings to the wholesale system, just as generation is compensated, when the net-benefits test demonstrates that doing so would benefit wholesale purchasers overall.

3. Respondents and their amici also contend that although the Rule reduces wholesale rates, it does not maximize their view of "social welfare," broadly theorized, because it will encourage some market participants to refrain from using power at certain times when the society-wide benefits of using power assert-

edly exceed the society-wide costs. See Resp. Br. 52-53; Borlick Amicus Br. 16-20. But they cite no statutory basis or legal authority for the proposition that FERC must seek to maximize that or any other classroom conception of social welfare when it regulates the wholesale market. To the contrary, this Court has held that FERC has "broad discretion" to "choose a [ratemaking] method that entails an appropriate 'balancing of the investor and the consumer interests.'" *Morgan Stanley*, 554 U.S. at 532 (quoting *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944)). Here, FERC reasonably concluded that LMP is justified based on its indisputable benefits of lower wholesale rates at peak times and the enhanced reliability and competitiveness of the wholesale system.

In any event, respondents and their amici are mistaken that LMP-G is unambiguously preferable from a social-welfare perspective—an assertion at odds with Dr. Kahn's conclusion that LMP "pricing maximizes net social welfare." J.A. 1345. Most clearly, their models assume that demand-response commitments are primarily the result of *forgoing* electricity use rather than *shifting* electricity use to other time periods. But they do not dispute that demand-response providers "often shift electricity to a non-peak time rather than avoiding its consumption." Private Petitioners' Br. 28 (emphasis omitted); see Consumers Br. 5, 27. As we explain in our opening brief (at 54), in those circumstances, demand-response providers do pay the retail rate, but at a time when LMP is lower. A compensation formula that assumes that the demand-response provider is forgoing paying the retail rate when it makes the demand-response commitment would therefore undercompensate demand-

response providers that shift their power use. Respondents' answer to that problem (Br. 53 n.8) is entirely unclear.

There are other problems with respondents' social-welfare analysis. The "social value" that is assertedly lost often "may be entirely intangible, such as students sitting in classrooms that are 1 degree warmer in the summer or an office building's decorative water fountain being off for an hour." Consumers Br. 27. No legal principle required FERC to subordinate concrete, measurable, real-world improvements in wholesale pricing and reliability to abstract and often subjective notions of social value. And respondents entirely ignore the immense social benefits for electricity consumers and others that come from a more reliable interstate electricity grid that requires fewer transmission upgrades. See pp. 8-9, *supra*.

At most, it could be said that the overall effect of choosing LMP-G over LMP on total economic well-being is ambiguous and heavily dependent on subjective value assessments and predictive judgments about how demand-response providers would respond to reduced incentives. FERC certainly did not act arbitrarily in declining to undertake the Sisyphean task of identifying and estimating the net society-wide social-welfare effects of LMP versus LMP-G, and instead focusing on its core statutory mission: ensuring just and reasonable rates by preventing sharply increased wholesale prices at times of peak demand and enhancing the reliability and competitiveness of the interstate grid.

B. FERC Adequately Explained Its Decision To Adopt A Single Formula For All Operators

Respondents describe (Br. 50-51) the Rule as an "abrupt and unexplained" departure from prior FERC orders, pointing to a 2007 order permitting, over the dissent of two Commissioners, PJM to reduce its demand-response compensation from LMP to LMP-G. See *PJM Indus. Customer Coal.* v. *PJM Interconnection L.L.C.*, 121 F.E.R.C. ¶ 61,315 (2007); see also Resp. Br. 15-17. But respondents ignore other prior orders involving ISO New England, New York ISO, Midwest ISO, and California ISO in which FERC had authorized variations on LMP See Pet. App. 64a-65a. And respondents do not meaningfully engage with this Court's precedents, which reject the view that an agency's "policy change must be justified by reasons more substantial than those required to adopt a policy in the first instance." *Fox Television*, 556 U.S. at 514. Here, the Rule expressly acknowledged that FERC had allowed a period of experimentation with demand-response compensation formulas during the infancy of wholesale auction markets and explained why FERC had come to the conclusion that a uniform formula was justified. See FERC Br. 56-57. That determination was plainly a "conscious change," and it was supported by "good reasons." *Fox Television*, 556 U.S. at 515.

CONCLUSION

For the foregoing reasons and those stated in our opening brief, the judgment of the court of appeals should be reversed and the case remanded.

Respectfully submitted.

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Solicitor General

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